BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of

Department of Enforcement,

Complainant,

vs.

Michael Lee Bullock
Westlake, CA,

Respondent.

DECISION

Complaint No. 2005003437102

Dated: May 6, 2011

Registered representative alleged to have: (1) shared improperly in commissions directed to a member firm from a mutual fund company; (2) agreed to the receipt of compensation from a mutual fund company conditioned on past or future sales; (3) misrepresented information in letters to retirement fund clients; and (4) received compensation directly from a mutual fund company. Held, findings and sanctions modified.

Appearances

For the Complainant: Leo F. Orenstein, Esq., and Gary A. Carleton, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Ben Suter, Esq., and Garrett R. Wynne, Esq., Keesal, Young & Logan, San Francisco, CA

Decision

Michael Lee Bullock ("Bullock") appeals a FINRA Hearing Panel's April 17, 2009 decision finding that Bullock violated NASD Rules 2110 and 2830 by sharing in directed brokerage commissions from a mutual fund company, conditioning directed brokerage commissions on promises of mutual fund sales, receiving compensation directly from a mutual fund company, and misleading retirement fund customers about his receipt of directed brokerage

commissions and FINRA's investigation of him.[1] For these violations, the Hearing Panel suspended Bullock for six months in all capacities, suspended him for an additional six months as a principal, ordered him to requalify as a principal, and fined him $50,000. The Hearing Panel also assessed costs of $15,653.

After a thorough review of the record, we reverse the Hearing Panel's findings that Bullock violated Rules 2830 and 2110 by sharing in directed brokerage commissions from a mutual fund company and conditioning directed brokerage commissions on promises of mutual fund sales. We affirm the Hearing Panel's findings that Bullock violated Rules 2830 and 2110 by receiving compensation directly from a mutual fund company. We reverse in part and affirm in part the Hearing Panel's other findings. We reduce the sanctions to a $25,000 fine, 30-day principal suspension, and requirement to requalify as a principal. We also affirm the Hearing Panel's assessment of costs.

I. Background

Bullock has been registered with FINRA since the 1970s. From September 1990 through June 2007, Bullock was associated as a general securities representative and principal with member firm Securities America, Inc. ("SAI"). Bullock is currently registered with another member firm.

Bullock serviced union pension plans and employee 401(k) retirement plans almost exclusively.[2] In 2002 and 2003, the time of the conduct at issue, Bullock had approximately 17 union pension and retirement plan clients. He serviced his clients by conducting due diligence on various mutual funds and fund families and recommending certain fund investments to his clients' trustees or plan consultants. Bullock maintained what he referred to as a "watch list" of mutual funds that were under-performing, and he was the broker of record for each plan participant. Bullock maintained that when a pension plan signs on as one of his clients, he commits himself contractually to attend trust meetings, monitor investment performance, and conduct educational seminars for plan participants. Since approximately 1990, Bullock operated out of his own office in Calabasas, California, under the trade name "Innovative Employee Benefits Program" ("IEBP"). IEBP had no formal existence as a legal entity. IEBP was an Office of Supervisory Jurisdiction ("OSJ") of SAI, and Bullock was its only principal. Laurie Gilchrist was Bullock's regional compliance supervisor at SAI. At various times, IEBP employed one or two registered individuals in addition to Bullock.

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[1] Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice 08-57* (Oct. 2008). Because the complaint in this case was filed before December 15, 2008, the procedural rules that apply are those that existed on December 14, 2008. The conduct rules that apply are those that existed at the time of the conduct at issue.

[2] A "401(k) plan" refers to a retirement savings plan governed by the general rules related to pension, profit-sharing, and stock bonus plans under the United States' Internal Revenue Code. *See* 26 U.S.C. § 401.

During a portion of the relevant time, Bullock employed NTJ as his assistant at IEBP. NTJ was registered with SAI as a general securities representative. She also had a law degree and was a member of the California State Bar. Bullock described NTJ as very smart and hard-working, and he testified that he relied heavily on her work in operating IEBP.

II. Procedural History

In July 2007, FINRA's Department of Enforcement ("Enforcement") filed a complaint alleging that Bullock violated: (1) NASD Rules 2830(k)(7)(C)[3] and 2110 by improperly sharing in directed brokerage commissions that mutual fund company Massachusetts Financial Services ("MFS")[4] paid to SAI (cause one); (2) NASD Rules 2830(k)(4)[5] and 2110 by receiving directed commissions from MFS that were conditioned on promises of MFS mutual fund sales (cause two); (3) NASD Rule 2110 by negligently making misleading misrepresentations and omitting material information in oral and written communications with clients (cause three); (4) NASD Rules 2830(l)(1) and 2110 by receiving compensation directly from MFS rather than through SAI (cause four); and (5) Rule 2110 by concealing from SAI Bullock's receipt of compensation directly from MFS (cause five). FINRA filed the complaint as a result of findings in an unrelated Rule 2830 investigation of SAI.

The Hearing Panel dismissed allegations under cause one that Bullock's conduct violated NASD Rule 2830(k)(7)(C), but found that it nonetheless violated Rule 2110. The Hearing Panel found the violations as alleged under causes two, four, and five. As to cause three, the Hearing Panel found that Bullock generally omitted material information from communications with clients because he failed to tell them that he shared in directed brokerage commissions that MFS paid to SAI. The Hearing Panel also found that he misrepresented FINRA's investigation of his conduct in two written communications with clients and dismissed the allegations as to four other communications. The Hearing Panel fined Bullock $50,000, suspended him in all capacities for six months, suspended him for an additional six months as a principal, required that he requalify as a principal before acting in that capacity, and assessed costs.

For the reasons discussed in detail below, we dismiss the Hearing Panel's findings of violation under causes one, two, and five. Under cause three, we dismiss the Hearing Panel's

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[3] At the time of the misconduct alleged, the applicable section of Rule 2830 was numbered 2830(k)(6)(C), but otherwise read the same as section (k)(7)(C). The complaint noted that the applicable section had been renumbered.

[4] MFS is the parent company for several entities including MFS Fund Distributors, Inc., which was the fund distributor for MFS mutual funds, including some of the funds at issue in this case. For convenience, the term "MFS" will be used in this decision to refer to Massachusetts Financial Services and all of its underlying entities.

[5] At the time of the misconduct alleged, the applicable section of Rule 2830 was numbered 2830(k)(3), but otherwise read the same as section (k)(4). The complaint noted that the applicable section had been renumbered.

findings that Bullock generally omitted material facts regarding his sharing in directed brokerage commissions from oral and written communications with clients and affirm the finding that he negligently misrepresented FINRA's investigation of him in two written communications with clients, in violation of NASD Rule 2110. We also affirm the Hearing Panel's findings under cause four that Bullock improperly received compensation directly from MFS, in violation of NASD Rules 2830(l)(1) and 2110, and we dismiss the Hearing Panel's findings under cause five that Bullock violated Rule 2110 by concealing his receipt of commissions from SAI. Accordingly, we modify the sanctions imposed by the Hearing Panel. We reduce the fine to $25,000, eliminate the six-month suspension in all capacities, reduce the six-month principal suspension to 30 days, affirm the requirement to requalify as a principal, and affirm the assessed costs.

III. Facts

A. Bullock's Arrangement with SAI and MFS

Martin Beaulieu ("Beaulieu"), president of MFS Fund Distributors, testified that Bullock was a top producer for MFS in 2002. Bullock represented several plans that were heavily invested in MFS funds, including one of MFS's larger 401(k) plans, a theatrical and stage employee union that held approximately $60 million in assets under management. At the time and for several years prior, MFS had in place a "strategic alliance" with SAI whereby MFS directed commissions generated from portfolio transactions in mutual fund trading to SAI.[6]

In late 2001, Bullock met with Beaulieu in Boston to discuss Bullock's ideas for improving upon the products that MFS offered. Bullock also had ideas as to how MFS could better serve Bullock's clients that already were invested in MFS's products. At prior trade shows, Bullock had met MFS's institutional representative, Pat Collins ("Collins"). Collins had been marketing MFS mutual funds to union pension plans as an MFS employee, and Bullock hoped to work out a networking opportunity with Collins. Beaulieu advised Bullock that Collins was no longer associated with MFS. Beaulieu instead proposed that IEBP hire Collins and offered that MFS would cover IEBP's costs associated with employing Collins through the payment of directed brokerage to SAI. SAI would, in turn, pay these costs back to Bullock.[7]

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[6] Beaulieu testified that MFS utilized three methods to direct commissions to a strategic alliance partner: (1) MFS directed transactions to strategic alliance partners that could execute trades, and the partner earned brokerage commissions on trades; (2) MFS directed trades to a broker-dealer that agreed to share part of its commissions on the trades with the strategic alliance partner (known as "step-out" commissions); and (3) MFS directed transactions to a broker-dealer that agreed to transfer its entire trade commission to the strategic alliance partner. MFS's strategic alliance agreement with SAI involved the second of these methods – step-out commissions.

[7] Beaulieu's testimony and Bullock's testimony differed as to the details of Bullock's discussion with Beaulieu and whether Bullock or Beaulieu first suggested that Bullock hire Collins and share in SAI's directed brokerage payments from MFS. We do not find such details to be relevant to this case.

Beaulieu advised Bullock that MFS could not pay Bullock directly and that SAI would have to pay Bullock from the step-out commissions that it received through its strategic alliance with MFS.

Bullock understood from Beaulieu that MFS had contacted Tom Cross ("Cross"), senior vice president of product distribution at SAI, to discuss SAI's sharing directed brokerage from MFS with Bullock. Bullock also contacted Cross (at SAI) directly. Bullock testified that he relied on MFS and SAI to ensure that the proposal for Bullock to share in SAI's directed brokerage complied with regulatory requirements.

Bullock negotiated with Beaulieu, Cross, and Collins to finalize details. Eventually, they agreed that MFS would direct additional step-out commissions of $25,000 per month or $300,000 per year to SAI (over and above amounts already directed pursuant to MFS's and SAI's long-standing strategic alliance agreement). Under the arrangement, SAI agreed to pay Bullock a portion of those funds – originally 40% or $10,000 per month, later increased to $12,000 per month. Collins demanded, and Bullock agreed to pay him, a salary of $8,000 per month, plus coverage of his expenses, which Bullock estimated at $2,000 per month. Collins in turn joined IEBP as eastern regional manager and continued to work out of his own east coast office. He began work for IEBP on March 1, 2002.

Beaulieu testified that he hoped the arrangement would lead to an increase in sales of MFS mutual funds, but the agreement was not contingent on a specific amount of sales of MFS funds, nor did MFS or SAI impose any specific sales goals on Bullock, Collins, or IEBP. Furthermore, either MFS or SAI could terminate the arrangement at will at any time.

B. MFS's Direct Payment to Bullock

Several months into Collins' employment with IEBP, Bullock realized that he had not received any payments from SAI for March and April 2002. Bullock complained vehemently to Cross. Cross and others at SAI advised Bullock that he had not been paid because MFS had not directed any payments to SAI in accordance with the agreement. Bullock thereafter contacted Chris Doucet ("Doucet") at MFS. Doucet responded within a few days and stated that MFS would send a check directly to Bullock to expedite the process.[8] Bullock testified that he assumed that MFS's check would represent his 40% payout for two months (or $20,000) and SAI would receive a corresponding 60% payment. Bullock also assumed that MFS had directly notified SAI of the payment.

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[8] Enforcement argued that it was significant that Bullock sent what Enforcement identified as an invoice to MFS to obtain this payment. Bullock testified that he never sent an invoice to MFS, but that Doucet instructed him to submit to MFS proof that Collins had in fact started working at IEBP and justification for the expenses that IEBP covered for Collins. Per Doucet's request, Bullock sent MFS a detailed accounting of his March and April costs associated with IEBP's employment of Collins. Bullock did not provide SAI with a copy of the accounting. We do not find relevant to the issues under review whether Bullock, without prompting, generated an invoice that he sent to MFS or simply responded to MFS's request for an accounting of IEBP's Collins-related expenses.

On June 3, 2002, MFS sent Bullock a check in the amount of $20,807.32, payable to "Securities America Inc. c/o Innov. Employ. Benefit Prog. ATTN: Mike Bullock." Bullock endorsed the check "Michael Bullock/For deposit only" and deposited the check into his IEBP bank account. He did not notify SAI that he had received the check. At the time, SAI's compliance manual and branch office manager's manual required that any representative who received compensation, including reimbursements, from any source other than SAI must forward the funds to SAI to be processed through its compensation department.

Bullock's SAI commission statement indicated that, on June 17, 2002, Bullock also received "marketing reimbursement" payments from SAI for March, April, May and June totaling $40,000. Bullock thus received double payments (one from MFS and one from SAI) for the months of March and April 2002. Bullock testified that he was unaware prior to FINRA's investigation that he had received double payments for those months. After FINRA launched its investigation, Bullock attempted to refund money to SAI or MFS, but neither would accept.

C. MFS Ended All Directed Brokerage Activity

Unbeknownst to Bullock, MFS ceased all directed brokerage payments as of November 2003. Early in 2004, Bullock again noted that he had not received MFS-directed monthly payments from SAI, and he contacted Doucet to inquire about it. Bullock learned that MFS had ended all of its strategic alliance agreements, including its strategic alliance agreement with SAI, and that MFS had ended all directed brokerage payments. Bullock testified that IEBP could not afford to employ Collins without reimbursement from MFS, so he thereafter terminated Collins' employment.

Collins' employment with IEBP ran from March 2002 through February 2004, and Collins was not successful in bringing any new clients to IEBP. SAI paid Bullock a total of $262,500 (for the months of January 2002 through October 2003)[9] as his share of step-out commissions that SAI received from MFS. As discussed above, Bullock also received one payment of $20,807.32 directly from MFS.

IV. Discussion

A. Causes One and Two

For the reasons discussed below, we dismiss the Hearing Panel's findings of violation under causes one and two.

1. NASD Rule 2830(k)

FINRA adopted Rule 2830(k), the "Anti-Reciprocal Rule," to address SEC concerns about the use of directed brokerage to promote the sales of investment company shares. *See*

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[9] The record reflects that MFS chose to pay Bullock retroactively to January 2002 notwithstanding that Collins did not join IEBP until March 2002.

Reciprocal Portfolio Brokerage for Sales of Investment Company Shares, 37 Fed. Reg. 5290 (Mar. 14, 1972). In March 1972, the Commission issued a statement highlighting the pervasive problem of directed brokerage in the mutual fund industry. *See id.* The Commission noted that the exchange of brokerage commissions for sales of investment company shares created conflicts of interest that could cause retail firms to recommend investment company securities based on the receipt of commissions from that investment company rather than on the merits of the mutual funds. *See id.*

In response, FINRA adopted NASD Rule 2830(k) in July 1973. The rule is intended to curb conflicts of interest that could cause retail firms to recommend the purchase of investment company shares based upon the receipt of commissions from that investment company rather than the attributes of the investment. *See NASD Notice to Members 73-42* (May 1973). FINRA amended Rule 2830(k) in March 1981. The 1981 Amendments added Rule 2830(k)(7)(B), which permitted FINRA members, subject to certain restrictions, to sell or distribute shares of mutual funds that followed a disclosed policy of considering sales of their shares as a factor in the selection of retail firms to execute portfolio trades, subject to best execution. *See Order Approving Proposed Rule Change and Related Interpretation Under Section 36 of the Investment Company Act*, Exchange Act Rel. No. 17599, 1981 SEC LEXIS 1918 (Mar. 4, 1981).[10]

2. Cause One – Alleged Violations of NASD Rules 2830(k)(7)(C) and 2110

Cause one alleged that Bullock shared in directed brokerage commissions, in violation of NASD Rules 2110 and 2830(k)(7)(C), which at the time of the alleged misconduct was numbered (k)(6)(C). Early in this proceeding, Bullock filed a motion for summary disposition in which he argued that NASD Rule 2830(k)(7)(C) prohibits member firms from granting participation in directed brokerage commissions to salespeople, but that it does not directly prohibit the associated person's receipt of such commissions. The Hearing Officer denied the motion, but ruled that, because the complaint alleged that Bullock's receipt of directed brokerage commissions from SAI also violated Rule 2110 (just and equitable principles of trade), the Hearing Panel need not reach the issue of whether Rule 2830(k)(7)(C) prohibited a salesperson's

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[10] After the conduct at issue in this case, two rules related to directed brokerage practices were amended. On September 9, 2004, the Commission amended Rule 12b-1 to prohibit investment companies from paying for the distribution of their shares with brokerage commissions. *See Prohibition on the Use of Brokerage Commissions to Finance Distribution*, Rel. No. IC-26591, 69 Fed. Reg. 54728 (Sept. 9, 2004), 2004 SEC LEXIS 2027 (Sept. 2, 2004). On February 14, 2005, FINRA followed the Commission's lead by repealing Rule 2830(k)(7)(B) and adding NASD Rule 2830(k)(2). *See Order Approving Proposed Rule Change by NASD, Inc., Relating to Investment Company Portfolio Transactions*, Exchange Act Rel. No. 50883, 69 Fed. Reg. 77286 (Dec. 27, 2004), 2004 SEC LEXIS 3008 (Dec. 27, 2004). These changes to Rule 2830(k) resulted in an unqualified prohibition on reciprocal brokerage arrangements and preclude all FINRA members from selling or underwriting shares of mutual funds using directed brokerage.

receipt of brokerage commissions.[11] The Hearing Panel dismissed the allegation in cause one that Bullock's receipt of directed brokerage from SAI violated NASD Rule 2830(k)(7)(C) and proceeded only with respect to determining if Bullock's conduct violated Rule 2110. The Hearing Panel ultimately found that Bullock's conduct violated Rule 2110. The Hearing Panel's finding of violation was based on the theory that Bullock violated Rule 2110 because of his substantial participation in SAI's violation of Rule 2830(k)(7)(C).[12]

On the issue of whether an associated person can violate Rule 2830(k)(7)(C) or any other section of the reciprocal rule, Bullock argues two points. First, Bullock argues that the language in Rule 2830(a) precludes the application of all sections of Rule 2830 to registered representatives or principals and restricts its application to member firms only. Second, Bullock argues that the plain language of subsection (k)(7)(C) demonstrates that only firms can violate the subsection. We reject both arguments.

We begin our analysis by looking to the plain language of Rules 2830(a) and 2830(k)(7)(C). *See K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291-92 (1988) (holding that a statutory analysis must begin with the plain language of the rule). Rule 2830(a), at the time of the misconduct, was titled "Application" and read:

> This Rule shall apply *exclusively* to the activities of members *in connection with the securities of companies registered under the Investment Company Act of 1940*; provided however, that Rule 2820 shall apply, in lieu of this Rule, to members' activities in connection with "variable contracts" as defined therein. (Emphasis added.)

Rule 2830(k)(7)(C) read:

> No *member* shall, with respect to such *member's* retail sales or distribution of investment company shares, *grant to salesmen*, branch managers or other sales personnel any participation in brokerage commissions received by the member from portfolio transactions of an investment company whose shares are sold by the member, or from any covered account, if the commissions are directed by or identified with the investment company. (Emphasis added.)

The plain language of Rule 2830(a), which has not changed significantly since the inception of Rule 2830, is intended to indicate that the rule applies to member firms' activities in investment company securities, not other types of securities, including variable contracts. While Bullock reads the term "exclusively" in subsection (a) to limit the applicability of the rule to member firms and not associated persons, we read the term "exclusively" in subsection (a) to

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[11] The Hearing Officer also noted that Enforcement may not have adequately pled the violation in cause one because Rule 2830(k)(7)(C) prohibits only the grant, but not the receipt, of prohibited commissions.

[12] SAI was not a party to this proceeding because it had settled FINRA's allegations against it. *See* note 25, *infra*.

limit and define the securities to which the rule applies. We do not therefore find that the use of the term "exclusively" is intended to restrict the applicability of the rule to member firms only.

The plain language of Rule 2830(k)(7)(C) restricts member firms from granting associated persons a share of directed brokerage commissions. Correspondingly, during the period at issue, NASD Rule 0115 stated that persons associated with a member hold the same duties and obligations as a member under NASD's rules. *See Charles C. Fawcett, IV*, Exchange Act Rel. No. 56770, 2007 SEC LEXIS 2598, at *2 (Nov. 8, 2007) ("General Rule 115 extends the applicability of NASD rules governing members to their associated persons."). Therefore, an associated person could be liable under any subsection of Rule 2830, including Rule 2830(k)(7)(C), if as an associated person of a firm, the associated person is directly involved in the firm's violative conduct by, for example, granting salesmen participation in directed brokerage for sales of investment company shares. *Cf. Dep't of Enforcement v. Jordan*, Complaint No. 2005001919501, 2009 FINRA Discip. LEXIS 15, at *27-30 (FINRA NAC Aug. 21, 2009) (rejecting applicability argument similar to Bullock's in the context of Rule 2711); *Dep't of Enforcement v. Strong*, Complaint No. C04050005, 2007 NASD Discip. LEXIS 10, at *18-19 (NASD NAC Feb. 23, 2007) (imposing liability in Rule 2711 case on associated person who was directly involved in the conduct that led to the firm's violation), *aff'd*, Exchange Act Rel. No. 57426, 2008 SEC LEXIS 467 (Mar. 4, 2008).

Our understanding is consistent with FINRA's rule development history. In FINRA's filings with the Commission that led to the approval of Rule 2830, there is no suggestion that FINRA ever considered specifically limiting the application of Rule 2830 to member firms only. Indeed, nothing in the text of the rule or the rule's history even remotely suggests that FINRA intended to establish an exception to Rule 0115 when it drafted Rule 2830. As we stated in *Jordan*:

> The term "member" is ubiquitous in the rulebook, and NASD Rule 0115 is invoked in nearly every disciplinary case involving associated persons. For these reasons, had FINRA sought to take the unusual step of preventing a member's duties under an NASD Rule from applying to all or some associated persons, it would have communicated so in a clear way, such as expressly stating in the rule text, or in filings during the rule development process . . . .

Jordan, 2009 FINRA Discip. LEXIS 15, at *31. Thus, we find that an associated person can violate Rule 2830(k)(7)(C) by granting to any salesman, including himself, a branch manager or other sales personnel any participation in brokerage commissions received by the member from portfolio transactions of an investment company whose shares the member firm sells.

We dismiss cause one, however, because we find that the complaint did not adequately plead a violation of Rule 2830(k)(7)(C), and the theory of the violation alleged in the complaint is inconsistent with the Hearing Panel's finding of violation. Cause one alleged that Bullock shared in brokerage commissions on portfolio transactions directed to SAI by MFS and therefore violated Rule 2830(k)(7)(C). The theory of the complaint appears to be that Bullock's sharing in MFS's directed brokerage payments to SAI violated Rule 2830(k)(7)(C) and that, because he

violated Rule 2830(k)(7)(C), he also violated Rule 2110.[13] In order to support a violation of Rule 2830(k)(7)(C) by an associated person, however, the complaint must allege that the associated person participated in the firm's granting of directed brokerage payments to a prohibited individual, which differs from merely alleging and proving that an individual received a portion of a member firm's directed brokerage commissions. We do not find that the complaint adequately alleged a violation of Rule 2830(k)(7)(C).

We also find that the Hearing Panel's findings were inconsistent with the allegations in cause one. The Hearing Panel dismissed the allegation of a violation of Rule 2830 early in this proceeding. The Hearing Panel found that SAI (which was not a party to this proceeding) violated Rule 2830(k)(7)(C) and that Bullock's actions were an independent violation of Rule 2110 because he substantially participated in SAI's violation of Rule 2830. The complaint, however, contained a different theory of the Rule 2110 violation. The complaint alleged that Bullock violated Rule 2110 by violating another NASD Rule – Rule 2830.[14] Cause one of the complaint contained no independent theory of a violation of Rule 2110 other than that a violation of Rule 2830 also violates Rule 2110. We find that the scope of the allegations against Bullock and the theory of the violation contained in the complaint differ from the Hearing Panel's findings. This confusion may have impeded Bullock's ability to respond to the allegations against him. Before finding a violation of Rule 2110 based on an alternate theory from that contained in the complaint, Bullock had to have been given a fair opportunity to respond. We do not find that he was given that opportunity. We therefore dismiss the allegations of cause one. *See James W. Browne*, Exchange Act Rel. No. 58916, 2008 SEC LEXIS 3113, at *37 n.37 (Nov. 7, 2008) (dismissing allegations because of lack of clarity in FINRA's theory of the case); *James L. Owsley*, 51 S.E.C. 524, 528 (1993) (dismissing "findings of misconduct on matters that have not been charged and which respondents [did not have] a fair chance to rebut").[15]

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[13] Rule 2110 requires that members (and, through Rule 0115, associated persons) "observe high standards of commercial honor and just and equitable principles of trade." It is well established that a violation of other FINRA rules is a violation of Rule 2110. *Frank Thomas Devine*, 55 S.E.C. 1180, 1192 n.30 (2002).

[14] This is not to suggest that, if properly pled, Bullock's conduct might not have been found independently to have violated Rule 2110. *See Kirlin Sec., Inc.*, Exchange Act Rel. No. 61135, 2009 SEC LEXIS 4168, at *65 (Dec. 10, 2009) ("[I]n the absence of a violation of another securities rule or law, conduct may violate Rule 2110 if it is 'unethical' or committed in 'bad faith.'").

[15] Our review of Hearing Panel decisions is de novo. *See Kevin M. Glodek*, Exchange Act Rel. No. 60937, 2009 SEC LEXIS 3936, at *19 (Nov. 4, 2009) (stating that the NAC's review is de novo, and the NAC has the authority to make an independent finding), *aff'd*, No. 09-5325, 2011 U.S. App. LEXIS 6178 (2d Cir. Mar. 25, 2011). We therefore possess the authority to revisit any of the Hearing Panel's findings, including its decision early in the proceeding to dismiss the allegation that Bullock violated Rule 2830(k)(7)(C). We have determined, however, in light of our concerns as to the adequacy of the pleadings, not to revisit the Hearing Officer's dismissal. Furthermore, because the Hearing Panel dismissed the allegation that Bullock violated Rule 2830(k)(7)(C) well in advance of the hearing, we find that in order to provide Bullock with adequate notice and the opportunity fully to defend the Rule 2830(k)(7)(C)

[Footnote continued on next page]

3. Cause Two – Alleged Violations of NASD Rules 2830(k)(4) and 2110

Cause two alleged, and the Hearing Panel found, that Bullock violated NASD Rules 2830(k)(4) and 2110 by requesting or arranging directed brokerage commissions that were conditioned on promises of mutual fund sales. The relevant portion of Rule 2830(k)(4) provided:

> [N]o member shall request or arrange for the direction to any member of a specific amount or percentage of brokerage commissions *conditioned upon* that member's sales or promise of sales of shares of an investment company. (Emphasis added.)

Bullock argues that Enforcement failed to prove that the directed commissions that he received were "conditioned upon" his sales of MFS funds. We agree.

The Hearing Panel held that, although "there was no express requirement for any sales, [Bullock] understood that MFS expected the agreement to generate sales for MFS" and that "MFS similarly hoped and anticipated that the arrangement would ultimately lead to increased sales of MFS funds." The Hearing Panel held that these findings were sufficient to establish that the brokerage commissions that MFS directed to SAI were conditioned upon Bullock's sales or promises of sales of MFS funds.

We do not concur with the Hearing Panel's conclusions. The Hearing Panel cited to Bullock's testimony that Beaulieu had an expectation that Bullock's and Collins' new business would include sales of MFS funds because some of MFS's funds were, in Bullock's estimation, "decent." The Hearing Panel also relied on Beaulieu's hearing testimony that he hoped and anticipated that MFS fund sales would increase as a result of Bullock's work with Collins. Bullock also testified, however, that he did not expect that new business necessarily would result in additional sales of MFS funds and that Beaulieu understood that Bullock was pushing unbundled plans, which may or may not include MFS funds. Bullock testified that Beaulieu never stated that he expected that Collins would increase MFS fund sales and that he and Beaulieu never had an understanding that their arrangement was contingent upon an increase in MFS fund sales. Beaulieu testified that there was no "quid pro quo" arrangement of which he was aware between MFS and SAI, and he never discussed with SAI or Bullock specific expectations or sales amounts for MFS funds.

In 2008, we issued our first decision in a case involving a violation of Rule 2830(k). *See Dep't of Enforcement v. American Fund Distribs., Inc.*, Complaint No. CE3050003, 2008 FINRA Discip. LEXIS 13 (FINRA NAC Apr. 30, 2008), *appeal filed*, Admin. Proceeding No. 3-

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allegation, we would have to remand the case to the Hearing Panel. We decline to do so. Instead, we confine our review under cause one to the finding that Bullock violated Rule 2110.

13055 (May 28, 2008) (hereinafter "*American Funds*"). In *American Funds*, we found that American Funds Distributors ("AFD"), a mutual fund distributor, had requested or arranged for the direction of a specific amount or percentage of brokerage commissions to other members conditioned upon those members' sales of American Funds' mutual funds, in violation of Rule 2830(k). To increase fund sales, AFD provided top selling firms additional compensation called target commissions. AFD determined the amount for target commissions based on specific criteria tied to sales numbers. For instance, the top ten retailers received 15 basis points of the prior year's sales while other sellers received 10 basis points of the prior year's sales. AFD tracked sales of its mutual funds by participating firms, told the top-selling firms that they received target commissions as a reward for past sales, and advised top-selling firms that they had to maintain their high levels of sales to continue to receive target commissions. We concluded in *American Funds* that AFD had a quid pro quo arrangement with their sellers, in violation of Rule 2830(k).

Unlike in *American Funds*, the evidence here does not demonstrate a quid pro quo understanding or other arrangement to suggest that MFS's commission payments to Bullock through SAI were conditioned upon Bullock's past or future sales. There is no evidence that MFS and Bullock discussed Bullock's past sales figures or that MFS established goals or boundaries for future sales numbers.[16] Although both Bullock and Beaulieu testified that MFS may have anticipated a possible increase in MFS fund sales when Collins joined IEBP, both also testified unequivocally that MFS's brokerage commission payments to SAI, which had been ongoing for many years before Bullock's involvement, were unrelated to predetermined sales goals. Furthermore, either Bullock or MFS could have ended the arrangement without notice and at will. We do not find that the evidence supports a finding that MFS's payments to Bullock through SAI were conditioned upon sales or promises of sales of MFS funds and therefore dismiss the allegations of cause two.

B. Cause Three

Cause three of the complaint alleged that Bullock generally misrepresented material facts to his clients because he failed to disclose to them that he received step-out commissions from MFS through SAI, in violation of NASD Rule 2110. It also alleged specific violations with respect to six written documents. The Hearing Panel found that Bullock omitted material information generally in communications with his clients. The Hearing Panel held that, because

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[16] Enforcement entered into evidence two letters dated May 22, 2003, and July 1, 2003, to Bullock from the president of one of MFS's divisions. The May letter projected possible MFS fund sales for "Bullock's firm." The July letter suggested follow-up to "review future business plans." The Hearing Panel discounted the significance of the letters, noting that the May 22, 2003, letter was dated nearly 15 months after Bullock, MFS, and SAI had agreed to their commission arrangement. We also see little significance in these letters. There is no indication in the bodies of the letters or elsewhere in the evidence that the sales projections were tied to MFS's directed brokerage arrangement with SAI or Bullock. Moreover, both Bullock and Beaulieu attributed little significance to the letters and stated that there were no agreements or implied understandings connected to the projections stated in the letters and that the projections were purely aspirational.

Bullock was advising clients on the selection of mutual funds, his failure to disclose MFS's and SAI's directed brokerage arrangement (and his receipt of a portion of those commissions) was deceptive. As to the six specific documents identified in the complaint, the Hearing Panel found omissions in two and dismissed the allegations related to the remaining four. We affirm the Hearing Panel's findings as to the six specific documents, as detailed below, and, for the reasons indicated below, dismiss the Hearing Panel's findings that Bullock generally misrepresented and omitted material facts in communications with all of his customers by failing to disclose his receipt of a portion of SAI's directed brokerage.

1. General Failure to Disclose

We turn first to the allegation that Bullock violated Rule 2110 by failing to disclose to his customers that he received funds from MFS through its alliance with SAI.

The Hearing Panel found that Bullock had a duty to disclose his arrangement with MFS and SAI to his clients' trustees and plan consultants because, as Bullock admitted, he considered himself a fiduciary. We do not agree that this is the correct standard to determine whether Bullock's arrangement with MFS and SAI was a material fact that he had a duty to disclose to all of his clients. The appropriate standard to determine Bullock's duty to disclose is whether a reasonable investor – in this case, a reasonable pension fund or retirement account trustee or consultant – would consider the information significant with respect to his investment decisions. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). A misstated or omitted fact is material if a reasonable investor would have viewed the fact as having altered the "total mix" of information available to him. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

At the time when Bullock and MFS discussed Bullock's hiring Collins, SAI and MFS had already established their strategic alliance years before. We have considered that the fund trustees and plan consultants were knowledgeable about Bullock's recommendations and the mutual fund industry as a whole. They likely knew of the existence of the strategic relationships, which at the time were a common industry occurrence, such as the relationship between SAI and MFS, and had already considered that when making their investment decisions. The question, therefore, is whether Bullock's hiring of Collins, separate and apart from SAI's and MFS's strategic alliance, was significant information to Bullock's existing customers. We find that it was not, because it was anticipated that Collins would be prospecting for new union customers, not seeking to increase sales to IEBP's existing customers. The evidence indicates that Bullock's interest in Collins was related to Collins' union contacts and prior union affiliations and not his familiarity with or ability to increase IEBP's sales of MFS funds to existing customers. MFS agreed to cover Bullock's costs for employing Collins without conditioning it on future sales or relating it to Bullock's past sales of MFS products. In all, we do not find that the trustees and consultants for Bullock's retirement and pension fund clients would consider the details of Bullock's arrangement with MFS and SAI significant with respect their investment decisions or that it would have altered the total mix of information available to them. We find that the evidence in this case does not establish that Bullock had a legal duty to disclose to his customers his arrangement for the reimbursement of Collins' employment costs and therefore dismiss the finding that his failure to disclose this information violated Rule 2110.

2. Specific Allegations as to Six Documents

The complaint alleged that a Sheet Metal Workers' pension plan questioned Bullock's levels of compensation and that in letters dated May 15, 2003, and June 23, 2003, and a proposal dated March 28, 2003, Bullock failed to disclose the funds that he received from MFS through SAI to cover Collins' employment costs and that his failure violated NASD Rule 2110. The Hearing Panel dismissed the allegation and we affirm the dismissal. In the documents at issue, Bullock responded to questions from plan trustees and lawyers regarding how the plan would compensate Bullock and the actual costs that the plan and its participants would incur. The Hearing Panel found that Bullock reasonably understood these inquiries to relate to the Sheet Metal Workers' pension plan's out-of-pocket expenses for utilizing Bullock's services and responded by disclosing his receipt of finder's fees or sales commissions at the point of sale and Rule 12b-1 fees. The Hearing Panel found Bullock's testimony in this regard to be credible and found his understanding reasonable because the funds that he received from MFS to cover his employing Collins were not contingent on sales of MFS funds to the Sheet Metal Workers' pension plan or any other client. We affirm the Hearing Panel's dismissal of alleged violations as to Bullock's May 15, 2003, and June 23, 2003, letters and a March 28, 2003, proposal for the Sheet Metal Workers' pension plan.

The Hearing Panel also dismissed allegations that Bullock violated NASD Rule 2110 when he failed in an April 20, 2004, trust report to disclose, in connection with the Commission's investigation of MFS, that he had received funds related to his employment of Collins from MFS (through SAI). Bullock disclosed in the report that MFS had settled with the SEC in connection with an investigation of the mutual fund industry,[17] but he failed to disclose that he had received funds from MFS through SAI. The Hearing Panel held that MFS's press release announcing its settlement with the Commission expressly stated that the settlement related to MFS's agreements with brokerage firms that tied MFS's payment of directed brokerage to sales and assets based on specific formulas and was not related to Bullock's arrangement with MFS. Given that Bullock's arrangement with MFS and MFS's settlement with the Commission were unrelated, the Hearing Panel held that it was not misleading for Bullock to fail to disclose in the April 2004 trust report his arrangement with MFS. For the reasons stated, we affirm the Hearing Panel's dismissal of alleged violations tied to Bullock's April 2004 trust report.

The Hearing Panel found that Bullock negligently misrepresented facts to the International Alliance of Theatrical Stage Employees ("IATSE") pension fund in two letters. We affirm the Hearing Panel's findings. First, in a letter dated June 14, 2006, Bullock responded to a request for information from an IATSE representative regarding its 401(k) plan. The information request asked Bullock to answer questions relating to "the recent mutual fund and investment company scandals." The request asked specific questions about and sought disclosure of subpoenas and government investigations, if any, of Bullock, companies for which

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[17] On March 31, 2004, MFS settled Commission allegations related to its payment of directed brokerage commissions. Neither SAI nor Bullock was mentioned in MFS's settlement. MFS consented to a censure, a $50 million civil penalty, and a cease and desist order.

Bullock sells mutual funds, and SAI.[18] The request also included the following broad demand: "We would like full disclosure of all matters that may impact services or performance or the public perception thereof." Bullock responded: "This question relates directly to the mutual fund industry and as such is answered singularly by MFS." Bullock also disclosed MFS's settlements of administrative proceedings with the Commission and other regulators and pending civil litigation and investigations. He did not disclose FINRA's investigation of himself or SAI.

Second, in a February 2007 proposal for IATSE in which Bullock responded to the same questions regarding government investigations, Bullock responded:

> IEBP understands [your question] to be directed to the mutual funds and/or investment companies with which IEBP has dealings, as opposed to IEBP itself. The response below has been provided by [MFS]. IEBP is requesting responses from all of the outside mutual funds and investment companies recently added to the plan, and will provide such additional responses upon request.

The Hearing Panel found that Bullock's responses implied that he had no independent information relevant to the questions when, in fact, Bullock was aware that FINRA was investigating his and SAI's possible receipt of directed brokerage from MFS. We agree. A securities professional must "not only avoid affirmative misstatements but also must disclose 'material adverse facts.'" *Richard H. Morrow*, 53 S.E.C. 772, 781 (1998); *see also Hanly v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969) (holding that a securities professional must disclose to his customer facts that he knows and those that are reasonably ascertainable). When Bullock sent the June 2006 letter to IATSE, he already had received two FINRA requests for information dated December 12, 2005, and April 7, 2006, and had testified before FINRA on the record on April 5, 2006. When he submitted the February 2007 proposal to IATSE, he also had received a Wells notice from FINRA in July 2006.[19] We find that Bullock's failure to disclose FINRA's investigation of SAI and Bullock easily exceeds the requirements necessary to establish that

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[18] Subsequent to MFS's settlement with the Commission in March 2004, FINRA commenced an investigation of SAI that eventually led to FINRA's settling with SAI and the filing of the complaint in this matter. In connection with FINRA's investigation of SAI and Bullock, FINRA served Bullock with a Rule 8210 request for documents on December 12, 2005, and an additional request for information on April 7, 2006. FINRA sent Bullock a Wells letter on July 26, 2006.

[19] We find the omitted facts to be material. "A fact is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information available." *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *14 (Feb. 10, 2004). Here, Bullock's client generally asked for disclosure of all matters that may affect the public perception of Bullock, SAI and MFS, and specifically asked about government investigations and "the recent mutual fund and investment company scandals." It is reasonable for an investor, like IATSE, to have an interest in regulatory inquiries and investigations of mutual fund companies in which it invests, broker-dealers who handle its transactions, and registered individuals associated with those broker-dealers.

Bullock negligently misrepresented facts to IATSE and violated Rule 2110.[20] *See Faber*, 2004 SEC LEXIS 277, at *14 (finding that misrepresentations and omissions are inconsistent with just and equitable principles of trade).

C. Causes Four and Five

Cause four alleged, and the Hearing Panel found, that Bullock violated NASD Rules 2830(l)(1) and 2110 by accepting compensation directly from MFS. Cause five alleged, and the Hearing Panel found, that by cashing MFS's check for $20,807 and not advising SAI of his receipt of the funds, Bullock concealed funds from SAI, in violation of NASD Rule 2110. We affirm the Hearing Panel's findings as to cause four and dismiss as to cause five.

1. Cause Four – Violations of NASD Rules 2830(l)(1) and 2110

During the period under review, the relevant portion of Rule 2830(l)(1) provided:

> In connection with the sale and distribution of investment company securities, except as described below, *no associated person shall accept any compensation from anyone other than the member with which he is associated.* Direct payment is allowed if the member agrees, the member relies on SEC approval, the member treats the payment as compensation for purposes of the rules, and the member complies with recordkeeping requirements. (Emphasis added.)

Bullock accepted from MFS a check for $20,807.32 payable to "Securities America Inc. c/o Innov. Employ. Benefit Prog. ATTN: Mike Bullock." Bullock endorsed the check "Michael Bullock/For deposit only" and deposited the check into his IEBP bank account. He did not notify SAI that he had received the check. He does not deny his receipt of these funds, and he did not obtain prior agreement from SAI or otherwise discuss it with the firm. Bullock argues that his negotiating of the check was an innocent and isolated mistake and that Enforcement failed to prove a violation of Rule 2830(l)(1) because the evidence does not demonstrate that Bullock's receipt of funds was in connection with the sale and distribution of investment company securities. We do not agree.

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[20] Although we affirm the Hearing Panel's findings as to these two documents, we note that the Hearing Panel based its findings, in part, on two points with which we do not agree. The Hearing Panel found that Bullock's response to a question regarding the nature of any subpoena that he, SAI, or MFS may have received was misleading because Bullock did not disclose his and SAI's receipt of Rule 8210 requests for information from FINRA which, the Hearing Panel held, is "the same thing" from "a client's point of view." While we agree that, based on the broad "catch all" language used in IATSE's information request, Bullock should have disclosed FINRA's investigation, we do not view government subpoenas and FINRA Rule 8210 requests as "the same thing." The Hearing Panel also found that Bullock's failure to disclose FINRA's investigation of SAI and Bullock in response to IATSE's request for a description of any government investigations was misleading. While we agree, for the reasons stated above, that Bullock should have disclosed FINRA's investigation, we do not find that he was required to do so based on IATSE's question about government investigations. FINRA is a self-regulatory organization, not a government entity.

NASD Rule 0130 provides that FINRA's rules shall be interpreted in light of the purposes that FINRA seeks to achieve by its rules and FINRA's regulatory programs. The Commission similarly has emphasized that "provisions governing the securities industry should be construed, not strictly and technically, but flexibly to achieve their remedial purpose." *Donald M. Bickerstaff*, 52 S.E.C. 232, 234 (1995); *Reed A. Hatkoff*, 51 S.E.C. 769, 772 (1993) (interpreting FINRA jurisdictional provisions "flexibly to achieve their remedial purpose"). In a similar vein, the Supreme Court has embraced an expansive interpretation of "in connection with the purchase or sale of a security" language in the context of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and "in the offer or sale of a security" language contained in Section 17(a) of the Securities Act of 1933 ("Securities Act"). *See Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85 (2006) (holding that when the Court has interpreted "in connection with" in the context of Section 10(b), it has espoused a broad interpretation that comports with the longstanding views of the Commission; "[u]nder our precedents, it is enough that the fraud alleged 'coincide' with a securities transaction."); *SEC v. Zanford*, 535 U.S. 813, 819 (2002) (holding that Section 10(b) should be construed flexibly and adopting the Commission's broad reading of the phrase "in connection with"); *U.S. v. Naftalin*, 441 U.S. 768, 773 (1979) (holding that the phrase "in the offer or sale," in the context of Section 17(a), is expansive enough to encompass the entire selling process).

Following these precedents, we find that Bullock's receipt of funds from MFS occurred in connection with his sales of MFS funds. Bullock testified that he hired Collins with the hope that Collins would help him develop labor unions as new clients to whom Bullock would sell securities. (Bullock acted as broker of record for the various pension and retirement funds that he serviced.) Bullock understood also that MFS anticipated that his employment of Collins would generate sales of MFS products. Beaulieu testified that he expected Collins to expand Bullock's business and increase his mutual fund sales, particularly his sales of MFS products. Additionally, MFS sent the $20,807.32 check (payable to SAI) to Bullock as part of its directed brokerage arrangement with SAI. MFS directed the funds to SAI as step-out commissions, which means that they were a portion of securities commissions that MFS paid to another broker-dealer in exchange for the execution of trades and the other broker-dealer shared a portion with SAI. We find that the $20,807.32 check from MFS that Bullock deposited into IEBP's account represented funds that were paid in connection with the sale and distribution of investment company securities. *Cf. Dep't of Enforcement v. Love*, Complaint No. C3A010009, 2003 NASD Discip. LEXIS 17, at *30 (NASD NAC May 19, 2003) (holding, in connection with FINRA's interpretation of NASD Rule 3040, that the phrase "participate in any manner" must be interpreted broadly to further FINRA's regulatory purpose), *aff'd*, Exchange Act Rel. No. 49248, 2004 SEC LEXIS 318 (Feb. 13, 2004).

We affirm the Hearing Panel's findings under cause four that Bullock violated Rules 2830(l)(1) and 2110.[21]

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[21] A violation of another FINRA Rule is inconsistent with just and equitable principles of trade and therefore violates Rule 2110. *Devine*, 55 S.E.C. at 1192.

2. Cause Five – Concealment of Funds

Cause five alleged, and the Hearing Panel found, that Bullock kept his receipt of $20,807.32 from MFS "secret" from SAI. The Hearing Panel found that Bullock's concealment from SAI of his receipt of $20,807.32 from MFS was inconsistent with just and equitable principles of trade and a violation of Rule 2110.

SAI's policies and procedures required Bullock, upon receiving MFS's check, to forward the check to SAI's main office. We agree that Bullock neither followed firm procedures with respect to MFS's check nor reported his receipt of the check to SAI. We do not find, however, that Bullock actively sought to conceal his receipt of the check from SAI or that he acted unethically. Bullock deposited the check into IEBP's bank account and documented the deposit on IEBP's records, to which SAI had full access. Although we find that Bullock's recordkeeping was sloppy, we do not find that his practices were unethical. We therefore do not find under cause five that Bullock independently violated Rule 2110 by actively concealing his receipt of funds from MFS. *Cf. Kirlin Sec. Inc.*, 2009 SEC LEXIS 4168, at *65 (holding that, in the absence of the violation of another securities law, conduct may violate Rule 2110 only if it is unethical).

V. Procedural Arguments

Bullock raises several procedural arguments. First, Bullock argues that the Hearing Officer did not timely issue the Hearing Panel decision. Second, he argues that the Hearing Officer exhibited bias and prejudice against him. Third, he argues that he is the victim of selective prosecution and that Enforcement's action should be blocked by the equitable doctrine of "unclean hands." Bullock contends that, as a result of these perceived procedural irregularities, he was denied a fair process. We reject these arguments, as outlined in detail below.

A. Hearing Panel Decision

NASD Rule 9268 requires the Hearing Officer to *prepare* a written decision within 60 days after the final date allowed for filing proposed findings of fact, conclusions of law, and post-hearing briefs. Bullock argues that, because closing arguments were presented on May 7, 2008, the Hearing Panel erred in not *issuing* its decision until April 17, 2009, 345 days later.

While Rule 9268 directs that the Hearing Officer "prepare" a written decision within 60 days, the rule does not require that the Hearing Panel *issue* its decision within the same 60 days. After the Hearing Officer prepares a draft of the Hearing Panel's decision, he must then distribute it for approval to the other members of the Hearing Panel and provide them with an opportunity to review the decision and recommend revisions. The Commission has rejected similar arguments. *See Morton Bruce Erenstein*, Exchange Act Rel. No. 56768, 2007 SEC LEXIS 2596, at *24 (Nov. 8, 2007) (rejecting argument that Rule 9268 requires issuance of Hearing Panel decision in a 60-day time period), *aff'd*, 316 F. App'x 865 (11th Cir. 2008); *Daniel Richard Howard*, Exchange Act Rel. No. 46269, 2002 SEC LEXIS 1909, at *13 (July 26, 2002) (rejecting argument that Hearing Panel decision was null and void because it was issued more than 60 days after the completion of the Hearing Panel proceedings), *aff'd*, 77 F. App'x 2 (1st Cir. 2003). We too have consistently rejected this argument. *See Dep't of Enforcement v.*

Lee, Complaint No. C06040027, 2007 NASD Discip. LEXIS 6, at *47 (NASD NAC Feb. 12, 2007), *sustained in part and remanded in part on unrelated grounds*, Exchange Act Rel. No. 57655, 2008 SEC LEXIS 819 (Apr. 11, 2008) (same).

We do not find that FINRA denied Bullock fair process because it did not issue its decision within 60 days.

B. Hearing Officer Bias

Bullock argues for the first time on appeal that, at the commencement of the third day of the Hearing Panel hearing, the Hearing Officer distributed to the parties a copy of our decision in *American Funds*, and loudly proclaimed "we won." Bullock argues that this demonstrates bias on the part of the Hearing Officer and, as a result, he was denied a fair hearing. Bullock also argues that the Hearing Officer's distributing the *American Funds* decision, alone, without a proclamation of "we won," is sufficient to demonstrate bias.[22] Bullock did not raise this issue during the Hearing Panel hearing.

Bullock could have moved, on the third day of the Hearing Panel hearing, when the alleged incident occurred, to disqualify the Hearing Officer. NASD Rule 9233 states that a party to a disciplinary proceeding may move to disqualify a Hearing Officer. The motion must be based on a reasonable, good faith belief that a conflict of interest or bias exists or circumstances otherwise exist where the Hearing Officer's fairness might reasonably be questioned. The rule provides that the moving party file a motion to disqualify a Hearing Officer within 15 days of learning of the facts that are the grounds for disqualification or of learning of the assignment of the Hearing Officer. Such motions are decided by the Chief Hearing Officer.

In this case, Bullock failed to comply with Rule 9233 and did not file a motion to disqualify the Hearing Officer at all, let alone within 15 days of the alleged occurrence. Indeed, Bullock failed to make any type of record of the event and failed even to flag the issue below, when it could have been addressed and, if necessary, rectified. Bullock counters that the controversy was not "ripe" until Bullock received a negative Hearing Panel decision. We disagree. "Adverse rulings, by themselves, generally do not establish improper bias." *Scott*

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[22] Bullock requested, and the NAC subcommittee granted, leave to adduce additional evidence on appeal in the form of affidavits from Bullock's two attorneys in which the attorneys swear that they witnessed the Hearing Officer claim loudly "we won" as he distributed copies of the *American Funds* decision. Enforcement does not dispute that the Hearing Officer distributed the *American Funds* decision to the parties and their attorneys. The NAC subcommittee granted Enforcement leave to adduce responsive affidavits, in which two Enforcement attorneys who were present at the Hearing Panel hearing claim that they have no recollection of the Hearing Officer's proclaiming "we won" as he distributed copies of the *American Funds* decision. One Enforcement attorney recalled that a Hearing Panel member asked the Hearing Officer how the *American Funds* case turned out, and the Hearing Officer responded in substance that the Hearing Panel had been upheld on appeal. Enforcement attempted unsuccessfully to obtain affidavits from the Hearing Officer and two Hearing Panel members. We adopt the NAC subcommittee's determinations with respect to the parties' motions to adduce additional evidence.

Epstein, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217, at *62 (Jan. 30, 2009), *aff'd*, No. 09-1550, 2010 U.S. App. LEXIS 24119 (3d Cir. Nov. 23, 2010). We find that, by waiting until this appeal to raise the issue of Hearing Officer bias, Bullock waived the argument. If Bullock had raised the issue properly, pursuant to Rule 9233(b), the Chief Hearing Officer, not the Hearing Officer who presided over the case, would have decided the matter by investigating immediately and, if necessary, replacing the Hearing Officer assigned to the case. *See Robert Fitzpatrick*, 55 S.E.C. 419, 431 (2001) ("We have required that objections to the composition of the Hearing Panel be raised first to the Hearing Panel so that the situation can be considered and, if appropriate, remedied as soon as possible."), *aff'd*, 63 F. App'x 20 (2d Cir. 2003); *Brooklyn Capital & Sec. Trading, Inc.*, 52 S.E.C. 1286, 1294 n.34 (1997) ("As we have held, we are not required to consider objections that were not raised at a time when the matter complained of could have been remedied."), *citing Stephen Russell Boadt*, 51 S.E.C. 683, 685 (1993). We hold that Bullock waived this argument by failing to raise it before the Hearing Panel.

Furthermore, although we find that Bullock has waived this issue by failing earlier in the proceeding to raise it, we also find that the record evidence presently before us does not demonstrate bias on the part of the Hearing Officer. *Cf. Epstein*, 2009 SEC LEXIS 217, at *62 (finding no evidence of Hearing Panel bias and holding that adverse rulings generally do not demonstrate improper bias); *Fitzpatrick*, 55 S.E.C. at 431-32 (finding no evidence of Hearing Panel bias and holding that, even if Hearing Panel member made the alleged prejudicial statement at issue, there is no evidence that the Hearing Panel member formed an opinion in the case based on anything other than the evidence before the Hearing Panel). Additionally, our de novo review would cure Hearing Officer prejudice if any had existed. *Dep't of Enforcement v. Dunbar*, Complaint No. C07050050, 2008 FINRA Discip. LEXIS 18, at *33 (FINRA NAC May 20, 2008) (holding that the NAC's de novo review cures alleged Hearing Panel prejudice); *Dep't of Mkt. Regulation v. Yankee Fin. Group, Inc.*, Complaint No. CMS030182, 2006 NASD Discip. LEXIS 21, at *52 (NASD NAC Aug. 4, 2006) (holding that the NAC's de novo review cures alleged Hearing Panel bias or unfair treatment), *aff'd in part and remanded for reconsideration of sanctions sub nom. Richard S. Kresge*, Exchange Act Rel. No. 55988, 2007 SEC LEXIS 1407 (June 29, 2007).

C. Selective Prosecution and Unclean Hands

Bullock argues as an affirmative defense that Enforcement's action should be blocked by the doctrine of "unclean hands."[23] He argues that Enforcement ruined his business and career by issuing a press release simultaneously with filing the complaint in this matter. Bullock further argues that, because other broker-dealers operated under step-out and directed brokerage agreements similar to SAI's arrangement with MFS, Enforcement's filing of a complaint against him was selective prosecution.[24] As discussed in detail below, we reject both arguments.

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[23] The "unclean hands" doctrine is a longstanding equitable concept according to which an adjudicator may withhold equitable relief from a party who is guilty of wrongdoing related to the controversy. *See Dep't of Enforcement v. Morgan Stanley DW Inc.*, Complaint No. CAF000045, 2002 NASD Discip. LEXIS 11, at *30 (NASD NAC July 29, 2002).

[24] Prior to the Hearing Panel hearing, Enforcement moved to strike Bullock's unclean hands and selective prosecution defenses. The Hearing Officer granted the motion, struck the defenses,

[Footnote continued on next page]

We first address Enforcement's issuance of a press release. FINRA's 2006 policy on the issuance of press releases was detailed in IM-8310-2 (Release of Disciplinary and Other Information Through the Public Disclosure Program). The policy states that FINRA may release complaints involving significant policy or enforcement determinations. It further states that the release of such information must be accompanied by the proviso that allegations are not true until proven. On July 11, 2007, FINRA issued a press release in which it reported that it had settled its case against SAI for improperly sharing directed brokerage commissions with Bullock and the failure properly to supervise Bullock.[25] The press release also announced that FINRA had filed a separate complaint against Bullock and accurately outlined the allegations against him. In addition, the press release stated:

> The issuance of a disciplinary complaint represents the initiation of a formal proceeding by NASD in which findings as to the allegations in the complaint have not been made and does not represent a decision as to any of the allegations contained in the complaint. Because this complaint is unadjudicated, interested persons may wish to contact the respondent before drawing any conclusions regarding the allegations in the complaint.

We find that FINRA complied with its own procedures in issuing the press release, which accurately depicted the nature of the allegations against Bullock, noted that he could respond to the complaint, and indicated that the allegations did not represent findings of wrongdoing. We find no evidence of wrongdoing by FINRA with respect to the press release. *Cf. Robert E. Strong*, Exchange Act Rel. No. 57426, 2008 SEC LEXIS 467 (Mar. 4, 2008) (declining to treat NASD's issuance of a press release that announced the filing of a complaint as a sanction).

Bullock asserts the claim of "unclean hands" as an affirmative defense. An affirmative defense is a respondent's assertion raising facts and arguments that, if true, will defeat the claims against the respondent, even if all of the allegations in the complaint are proven. *Rochelle Saks v. Franklin Covey Co.*, 316 F.3d 337, 350 (2d Cir. 2003) (quoting BLACK'S LAW DICTIONARY 430 (7th ed. 1999)); *accord Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. City Savings, F.S.B.*, 28 F.3d 376, 393 (3d Cir. 1994). "The practice in disciplinary proceedings is to strike those affirmative defenses that do not constitute a valid defense to avoid wasting time litigating irrelevant facts." *Dep't of Enforcement v. Epstein*, Complaint No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *88 (FINRA NAC Dec. 20, 2007), *aff'd* Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217 (Jan. 30, 2009). Here, even if Bullock had proven that he lost business as a result of FINRA's press release that would not excuse or negate his underlying violations of Rules 2830 and 2110. Thus, the defense fails. *Cf. FTC v. Image Sales and Consultants, Inc.*,

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[cont'd]

and blocked Bullock's introduction of related evidence, such as evidence of how the press release ruined his career and of similar misconduct by other broker-dealers.

[25] According to the terms of FINRA's settlement with SAI, SAI paid a fine of $375,000.

No. 97-Civ.-131, 1997 U.S. Dist. LEXIS 18942, at *7-8 (N.D. Ind. Sept. 17, 1997) (finding that the doctrine of unclean hands may not be invoked as an affirmative defense against a regulatory agency that is attempting to enforce a congressional mandate in the public interest); *FDIC v. Isham*, 782 F. Supp. 524, 531-32 (D. Colo. 1992) ("FDIC's conduct in fulfilling its mandate involves discretionary decisions that should not be subject to judicial second guessing.").[26]

We similarly find no support for Bullock's argument that FINRA improperly targeted him for selective prosecution. To establish a claim of selective prosecution, the respondent must demonstrate that he was singled out unfairly for prosecution based on improper considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right. *See Epstein*, 2009 SEC LEXIS 217, at *53. Bullock has made no such showing, and we reject this argument. *See Nicholas T. Avello*, Exchange Act Rel. No. 46780, 2002 SEC LEXIS 2833, at *20 (Nov. 7, 2002) (rejecting selective prosecution argument and holding that NASD has wide discretion in deciding against whom to proceed), *aff'd*, 454 F.3d 619 (7th Cir. 2006); *DBCC v. Roach*, Complaint No. C02960031, 1998 NASD Discip. LEXIS 11, at *19 (NASD NAC Jan. 20, 1998) (rejecting argument that FINRA was biased against respondent and that she was selectively prosecuted because her husband had been barred).[27]

VI. Sanctions

The Hearing Panel fined Bullock $50,000, suspended him in all capacities for six months, suspended him an additional six months in all principal capacities, required that he requalify as a principal, and assessed costs of $15,653. In light of our dismissal of several of the Hearing Panel's findings, we modify these sanctions as detailed below. We reduce the fine to $25,000, eliminate the six-month suspension in all capacities, reduce the six-month principal suspension to 30 days, affirm the requirement that Bullock requalify as a principal, and affirm the Hearing Panel's imposition of costs. We do not impose additional costs on appeal.

We turn first to the relevant FINRA Sanction Guidelines ("Guidelines").[28] The Guidelines for negligent misrepresentations and omissions recommend a fine of $2,500 to

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[26] Because we do not find relevant to the issues before us whether Bullock suffered economic hardships as a result of the press release or the complaint, we do not find that the Hearing Panel erred in excluding evidence in this regard. *See* NASD Rule 9263 (Evidence: Admissibility) (stating that the Hearing Officer shall exclude all evidence that is irrelevant).

[27] We similarly reject Bullock's claim that the Hearing Panel erred in preventing him from introducing evidence that other firms engaged in similar conduct, but were not disciplined. *See Epstein*, 2009 SEC LEXIS 217, at *55; *Patricia H. Smith*, 52 S.E.C. 346, 348 n.8 (1995) ("[I]t is no defense that others in the industry may have been operating in a similarly illegal or improper manner.").

[28] *FINRA Sanction Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions); 15 (Selling Away); 90 (Misrepresentations or Material Omissions of Fact) (2010), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf, [hereinafter "*Guidelines*"].

$50,000 and a suspension in any or all capacities for up to 30 business days. There are no Guidelines directly applicable to violations of Rule 2830(l)(1) (Bullock's receipt of payment from MFS), so we have consulted the Guidelines for selling away,[29] which recommend a fine of $5,000 to $50,000. The Guidelines also provide aggravating and mitigating factors that we must consider.

The Hearing Panel found that Bullock failed to accept responsibility for his conduct and that his failure was aggravating.[30] While we agree that a failure to accept responsibility for one's misconduct may be aggravating, we do not find that Bullock's actions should be so characterized. Bullock launched a hearty defense and contested the allegations against him. He is entitled under FINRA's rules to fully defend himself against the allegations of the complaint. At the time of the misconduct, it was widely known that many broker-dealers had entered into directed brokerage arrangements with mutual fund companies. While this fact does not excuse misconduct on the part of Bullock or any other member of the industry, we do not attribute his steadfast insistence that his actions were not violative as a refusal to accept responsibility. Indeed, when FINRA examiners advised Bullock that he received a double payment (one from MFS and one from SAI) for the months of March and April 2002, he attempted to return the funds to MFS or SAI. We find, based on the unique facts here, that Bullock did not evade responsibility for his own actions. Rather, he strenuously defended himself against allegations, as he was entitled under FINRA's rules to do. *Cf. Clinger and Co., Inc.*, 51 S.E.C. 924, 926 (1993) ("Persons charged with violations are entitled to pursue the procedural and substantive remedies [offered under FINRA's rules].").

The Hearing Panel also found that Bullock's misconduct rose to the level of recklessness and considered this as an aggravating factor.[31] We do not find that Bullock's conduct was reckless. While we find that Bullock was negligent in failing to follow SAI's procedures that prohibited him from accepting funds directly from MFS, failing to advise SAI that he had received funds from MFS, and failing to detect that he received a double payment for the months of February and March 2002, we do not find that Bullock's actions rise to the level of recklessness. Bullock has not engaged in a pattern of violative conduct, nor does he have a disciplinary history after nearly 40 years in the securities industry.[32] We therefore are unable to find that his negligence rises to the level of recklessness. We find that his actions were negligent, and we have imposed sanctions accordingly.

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29 "For violations that are not addressed specifically, Adjudicators are encouraged to look to the guidelines for analogous violations." *Guidelines*, at 1 (Overview).

30 *See Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, No. 2).

31 *Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, No. 13).

32 We note, however, that Bullock's lack of disciplinary history is not a mitigating factor. *Rooms v. SEC*, 444 F.3d 1208, 1214-15 (10th Cir. 2006) (holding that, while the existence of a disciplinary history is an aggravating factor when determining appropriate sanctions, its absence is not mitigating).

Bullock argues that we should find mitigating that he did not directly harm members of the investing public and should consider as a reason for imposing lesser sanctions that FINRA's disciplinary action already has caused significant loss for him. We reject these as mitigating factors. Even though the record before us does not demonstrate that Bullock's misconduct harmed the investing public, the fact that it potentially could have resulted in harm or in any way threatened the firm or its customers suggests that lack of customer harm should not be considered mitigating. *See Dep't of Enforcement v. Prout*, Complaint No. C01990014, 2000 NASD Discip. LEXIS 18, at *15 (NASD NAC Dec. 18, 2000) (rejecting absence of customer harm as a mitigating factor). Similarly, we and the Commission have rejected the concept that the harm, economic or otherwise, that befell the respondent as a result of his actions or FINRA's proceedings should factor into a sanctions determination. *See Jason A. Craig*, Exchange Act Rel. No. 59137, 2008 SEC LEXIS 2844, at*27 (Dec. 22, 2008) (holding that the Commission does not "consider mitigating the economic disadvantages [the respondent] alleges he suffered because they are a result of his misconduct"); *Dep't of Enforcement v. Jordan*, Complaint No. 2005001919501, 2009 FINRA Discip. LEXIS 15, at *53-54 (NASD NAC Aug. 21, 2009) (rejecting argument that respondent's contention that her "personal and business reputation [have been] besmirched and livelihood threatened" should warrant a reduction in sanctions).

We find aggravating Bullock's wholehearted and readily admitted failure to keep abreast of FINRA rules, particularly Rule 2830, and SAI's policies and procedures related to the receipt of commissions from outside sources. Bullock never took the time to review closely SAI's policies or FINRA's rules before accepting direct payment from MFS. Bullock was extremely proactive – contacting individuals both at SAI and MFS – when he believed that MFS and SAI had not paid him promptly, yet he made little effort to ensure that the arrangement to which he agreed complied with applicable rules and procedures and did not keep SAI apprised of payments that he received from MFS. We find that his actions were negligent and that his *laissez-faire* attitude towards ensuring compliance with FINRA rules and SAI procedures is aggravating. *See e.g. Dep't of Enforcement v. Van Dyk*, Complaint No. C3B020013, 2004 NASD Discip. LEXIS 12, at *27-28 (NASD NAC Aug. 9, 2004) (finding respondent's indifference to keeping abreast of applicable rules aggravating).

For violating Rules 2830(l)(1) and 2110 by accepting payment from MFS and failing to forward the payment immediately to SAI, we fine Bullock $20,000, which fines away the double payment that Bullock received. We note that, by failing to forward MFS's $20,807 check to SAI before depositing it, or otherwise advising SAI of Bullock's receipt of the funds, Bullock prevented SAI from supervising his receipt of the money, enforcing its own procedures, and reflecting the funds on its books. Bullock also failed to detect SAI's double-payment, which enabled Bullock to profit monetarily (albeit not intentionally) from his actions, an additional factor that we have considered aggravating.[33]

For violating Rule 2110 by omitting and misrepresenting material facts in two written communications with clients, we fine Bullock $5,000, order that he requalify as a principal, and suspend him for 30 days in all principal capacities. In response to a direct request for "disclosure of all matters that may impact services or performance or the public perception thereof," Bullock

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[33] *Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, No. 17).

failed to disclose that he and SAI were under FINRA investigation. We find that Bullock ignored his customer's concerns and stymied his customer's discovery of material information that could have potentially affected the customer's investment choices.

VII. Conclusion

We affirm the Hearing Panel's findings that Bullock violated NASD Rules 2830(l)(1) and 2110 by improperly receiving compensation from a firm other than SAI, the member firm with which he was associated. We also affirm the Hearing Panel's findings that Bullock violated Rule 2110 by misrepresenting and omitting material information in two written communications with customers. We dismiss all other findings of violation. For these violations, we fine Bullock $25,000, suspend him for 30 days in all principal capacities, and require that he requalify as a principal before acting in any principal capacity. We also affirm the Hearing Panel's assessment of hearing costs of $15,653. The suspension imposed in this decision will become effective on a date to be determined by FINRA.[34]

On Behalf of the National Adjudicatory Council,

Marcia E. Asquith

Marcia E. Asquith, Senior Vice President
and Corporate Secretary

[34] Pursuant to FINRA Rule 8320, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days notice in writing, will summarily be revoked for non-payment.